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In the Supreme Court of the United States

OCTOBER TERM, 1932

No. —

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

FREDERICK B. WELLS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Eighth Circuit entered February 4, 1933.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 57–63) is reported in 19 B. T. A. 1213. The opinion of the Circuit Court of Appeals has not yet been reported.

This Court's dismissal of a certificate in this case on May 2, 1932, is reported in 286 U. S. 529.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered February 4, 1933. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether Section 219 (h) of the Revenue Acts of 1924 and 1926 is unconstitutional when applied to the income of irrevocable trusts created before 1924.

STATUTES INVOLVED

Section 219 (h) of the Revenue Act of 1924, c. 234, 43 Stat. 253, provides as follows (U. S. C., Title 26, Sec. 960):

> Where any part of the income of a trust may, in the discretion of the grantor of the trust, either alone or in conjunction with any person not a beneficiary of the trust, be distributed to the grantor or be held or accumulated for future distribution to him, or where any part of the income of a trust is or may be applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in paragraph (10) of subdivision (a) of section 214), such part of the income of the trust shall be included in computing the net income of the grantor.

Section 219 (h) of the Revenue Act of 1926, c. 27, 44 Stat. 9 (U. S. C. App., Title 26, Sec. 960), is the same as Section 219 (h) of the Revenue Act of 1924, quoted above.

STATEMENT

On December 30, 1922, Frederick B. Wells created three trusts, referred to as Trusts Nos. 1, 2, and 3. On August 6, 1923, he created two additional trusts, referred to as Trusts Nos. 4 and 5. All were in terms irrevocable. (R. 47; Ex. 2–5, 14–19, 29–31, 45–48, 122–124.)[1]

By the provisions of Trust No. 1 Wells transferred certain shares of stock to the Minneapolis Trust Company as trustee. The trustee had fairly broad powers as to management, sale of assets, etc. The income of the trust property was to be used first to pay the net annual premium upon a life-insurance policy on Wells' life. The excess income was to be accumulated until an amount sufficient to pay one additional premium had been reserved. Any additional income was, in the discretion of the trustee, to be paid to Wells' daughter.

[1] On February 23, 1932, the Circuit Court of Appeals certified to this Court certain questions with respect to this case. The certificate was dismissed on May 2, 1932. *Wells* v. *Commissioner*, 286 U. S. 529. Thereafter the Circuit Court of Appeals granted the present petitioner's motion for reargument and directed that a supplemental record be furnished including the text of the provisions of the five trust agreements and the insurance policies involved. The abbreviation "Ex." refers to material in this supplemental volume of exhibits.

Upon the death of Wells the trustee was to collect the amount of the insurance policy and purchase from the Wells estate securities amounting to $100,000 at their appraised value. After Wells' death the income from the trust estate was to be paid to his daughter during her life. Upon the death of his daughter the trust was to cease and determine and the trustee was to pay over the corpus as the daughter might appoint by her will; in default of appointment or issue, then in equal parts to Wells' sons (who were named), when the youngest or the youngest survivor reached the age of twenty-five years. (Ex. 2–5.)

The other trusts were similar except for different limitations and different methods of making the policies payable to the trustee. It is deemed unnecessary to point out these differences in detail for the purpose of this petition. In Trusts Nos. 2 and 3 (Ex. 14–19, 29–31) the corpus of the trusts was payable at Wells' death to the Minneapolis Foundation, a corporation organized for charitable and benevolent purposes in trust to the rector, wardens and vestrymen of St. Marks Church, Minneapolis, Minnesota, for the sole purpose of carrying on the work of the Wells Memorial, a definite charity conducted by the church. It was provided that if the accumulation of income provided in the living trust should for any reason be declared void, the accumulation should be paid over to the Minneapolis Foundation for its own uses and purposes,

but should either the living trust or the perpetual trust be declared void as a trust then the trust estate should revert to Wells, if living, and if not, to his heirs, executors, administrators or assigns. (Ex. 17–18, 31.) Under Trusts Nos. 4 and 5 (Ex. 45–48, 122–124), the income from the trusts was to be used to pay premiums on certain accident policies as well as life insurance policies. The benefits under the accident policies, other than the death benefits, remained payable to Wells.

In auditing the taxpayer's returns for the years 1924, 1925, and 1926, the Commissioner included as taxable income of Wells so much of the income of the trusts as was used to pay the premiums on insurance policies taken out on Wells' life. (R. 56–57.) The Board of Tax Appeals sustained the Commissioner and determined deficiencies for the years 1924, 1925, and 1926.

On a petition for review filed by the taxpayer, the Circuit Court of Appeals held that only so much of the income of the trusts as was used to pay premiums on accident policies might be taxed to Wells and that the balance of the income might not be. The court held that Section 219 (h) of the Revenue Acts of 1924 and 1926 was intended to apply to irrevocable trusts created prior to the enactment of the Revenue Act of 1924 but that as so construed they were unconstitutional when applied to the trusts involved in this case.

SPECIFICATION OF ERRORS

The Circuit Court of Appeals erred:

1. In holding that the payment of the life insurance premiums by the trustees resulted in no benefit to Wells or his estate.

2. In holding that Section 219 (h) of the Revenue Acts of 1924 and 1926 is unconstitutional.

3. In holding that the effect of Section 219 (h) as applied to the facts in this case is to impose a tax upon that which was not Wells' income, in violation of the Sixteenth Amendment to the Constitution.

4. In holding that to impose a tax upon the settlor of an irrevocable trust created prior to the passage of the Revenue Act of 1924 with respect to the income of the trust used to pay premiums on insurance on his life constitutes a violation of the Fifth Amendment to the Constitution.

5. In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. Section 219 (h) of the Revenue Acts of 1924 and 1926 (*supra*, p. 2) was adopted for the purpose of preventing evasion of taxes by the creation of trusts the income of which is used to meet an expense ordinarily incurred by the individual himself, that is, insurance on his life. S. Rep. No. 398, 68th Cong., 1st Sess., pp. 25–26. In so far as the Circuit Court of Appeals has held that the provision is unconstitutional in that it taxes an indi-

vidual upon that which is not his income, it apparently makes no distinction between trusts created prior to the enactment of the Revenue Act of 1924 and those created thereafter. If permitted to stand, it defeats the purpose of Congress as to trusts created with notice of the provision as well as those created without notice of it and permits the escape from higher tax rates of a large amount of income. Hence, the question is an important one. It has been raised in a number of cases pending before the Board of Tax Appeals and the Circuit Courts of Appeals.

2. There is a direct conflict between the decision in this case and the reasoning of the Circuit Court of Appeals for the Third Circuit in the case of *du Pont* v. *Commissioner*, decided January 6, 1933, upholding the constitutionality of Section 219 (h) of the Revenue Acts of 1924 and 1926 as to trusts created prior to the enactment of the statute. The court below distinguished the *du Pont case* on the ground that the trusts were made irrevocable only for a period of three years from September 18, 1923, renewable at the settlor's option and actually renewed for two three-year periods after that time. But the decision of the court in the *du Pont case* was not rested on this narrow ground but on the broad one that the settlor was profiting by the arrangement by seeing to it that the income was applied to a purpose which he desired and required.

3. Coincidentally with the filing of this petition, the taxpayer in the *du Pont case* is filing a petition

for certiorari to review the decision of the Circuit Court of Appeals for the Third Circuit in that case. These two cases present a conflict of opinion between two Circuit Courts of Appeal upon an important constitutional question the decision of which seriously affects the administration of the revenue and substantial rights of a large number of taxpayers. It is therefore important that both cases be reviewed in this Court, and accordingly the Government will not oppose the granting of a writ in the *du Pont case*.

Wherefore, it is respectfully submitted that the petition should be granted.

THOMAS D. THACHER,
Solicitor General.

MARCH, 1933.

U. S. GOVERNMENT PRINTING OFFICE: 1933

PETITIONERS' BRIEF

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In the Supreme Court of the United States

OCTOBER TERM, 1932

No. 792

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

FREDERICK B. WELLS

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 45–50) is reported in 19 B.T.A. 1213. The opinion of the Circuit Court of Appeals (R. 56–83) is reported in 63 F. (2d) 425.

This Court's dismissal of a certificate in this case on May 2, 1932, is reported in 286 U.S. 529.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered February 7, 1933 (R. 83–84). The petition for a writ of certiorari was filed March 20,

1933, and was granted March 27, 1933. (R. 210). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether Section 219 (h) of the Revenue Acts of 1924 and 1926 is unconstitutional when applied to the income of five trusts created before 1924 by the taxpayer in this case.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in Appendix A, *infra*, pp. 32–37.

STATEMENT

On December 30, 1922, Frederick B. Wells created three trusts, referred to as Trusts Nos. 1, 2, and 3. On August 6, 1923, he created two additional trusts, referred to as Trusts Nos. 4 and 5. All were in terms irrevocable (R. 37; 86–88, 95–99, 107–109, 120–123, 181–183).[1]

By the provisions of Trust No. 1 Wells transferred certain shares of stock to the Minneapolis Trust Company as trustee. The trustee had fairly

[1] On February 23, 1932, the Circuit Court of Appeals certified to this Court certain questions with respect to this case. The certificate was dismissed on May 2, 1932. *Wells* v. *Commissioner*, 286 U.S. 529. Thereafter the Circuit Court of Appeals granted the present petitioner's motion for reargument and directed that a supplemental record be furnished including the text of the five trust agreements and the insurance policies involved.

broad powers as to management, sale of assets, etc. The income of the trust property was to be used first to pay the net annual premium upon a life insurance policy on Wells' life. The excess income was to be accumulated until an amount sufficient to pay one additional premium had been reserved. Any additional income was, in the discretion of the trustee, to be paid to Wells' daughter. Upon the death of Wells the trustee was to collect the amount of the insurance policy and purchase from the Wells estate securities amounting to $100,000 at their appraised value. After Wells' death the income from the trust estate was to be paid to his daughter during her life. Upon the death of his daughter the trust was to cease and determine and the trustee was to pay over the corpus as the daughter might appoint by her will; in default of appointment or issue, then in equal parts to Wells' sons (who were named), when the youngest or the youngest survivor reached the age of twenty-five years (R. 86–88).

The other trusts were similar except for different limitations and different methods of making the policies payable to the trustee, and it is not deemed necessary to point out these differences in detail here. Under Trusts Nos. 4 and 5 (R. 120–123, 181–183) the income from the trusts was to be used to pay premiums on certain accident policies as well as life-insurance policies. The benefits

under the accident policies, other than the death benefits, remained payable to Wells.[2]

In auditing the taxpayer's returns for the years 1924, 1925, and 1926, the Commissioner included as taxable income of Wells so much of the income of the trusts as was used to pay the premiums on insurance policies taken out on Wells' life (R. 44–45). The Board of Tax Appeals sustained the Commissioner and determined deficiencies for the years 1924, 1925, and 1926 (R. 50–51).

On a petiton for review filed by the taxpayer, the Circuit Court of Appeals held that only so much of the income of the trusts as was used to pay premiums on accident policies might be taxed to Wells and that the balance of the income might not be. The court held that Section 219 (h) of the Revenue Acts of 1924 and 1926 was intended to apply to irrevocable trusts created prior to the enactment of the Revenue Act of 1924 but that as so construed the provision was unconstitutional when applied to income of the trusts involved in this case (R. 56–83).

SPECIFICATION OF ERRORS

The Circuit Court of Appeals erred:

1. In holding that the payment of the life insurance premiums by the trustees resulted in no benefit to Wells or his estate.

2. In holding that Section 219 (h) of the Revenue Acts of 1924 and 1926 is unconstitutional.

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[2] Further facts relating to the detailed provisions of the trusts and insurance policies are stated in Point III (*infra*, pp. 23–31), where they become material.

3. In holding that the effect of Section 219 (h) as applied to the facts in this case is to impose a tax upon that which was not Wells' income, in violation of the Sixteenth Amendment to the Constitution.

4. In holding that to impose a tax upon the settlor of an irrevocable trust created prior to the passage of the Revenue Act of 1924 with respect to the income of the trust used to pay premiums on insurance on his life constitutes a violation of the Fifth Amendment to the Constitution.

5. In reversing the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

I

Section 219 (h) of the Revenue Acts of 1924 and 1926 (*infra*, p. 34) is plainly applicable to irrevocable trusts. We contend that the provision is not unconstitutional when so applied.

The statute seeks to tax nothing which is not income. We think it a reasonable exercise of the taxing power of Congress under the Sixteenth Amendment and therefore not unconstitutional under the due process clause of the Fifth Amendment. It is not enough for the settlor to show that he had no legal or equitable interest in the corpus of the trust or the income from it, and the respondent does not sustain his position by showing that he could not personally consume the income or principle of the trust and could exercise no control over the trusts beyond that which he impressed on them

by creating them. The question is not one of "title," "ownership" or actual "control," but whether it was a reasonable exercise of legislative power for Congress to tax to the settlor so much of the trust income as is used to pay premiums on policies of insurance on his own life.

The disposition which Wells made was in essence testamentary. It took final effect at his death and because of his death. The trust property could, therefore, be taxed by an appropriate statute as a part of Wells' estate on his death.

There is income in this case which Congress may tax, and that income is being used during Wells' life pursuant to his directions and in execution of his plan for the management of property which will pass to persons designated by him as the beneficaries of his bounty only upon his death. In providing that so much of this income as is used to pay the premiums upon policies of insurance on the settlor's life may be taxed to the settlor, we submit that Congress has acted reasonably and with a view to wise and equitable distribution of the burden of taxation.

Section 219 (h) was adopted by Congress as a means to prevent evasion, and it is similar in purpose and effect to other closely related provisions which have been uniformly upheld by this Court.

II

Section 219 (h) of the Revenue Acts of 1924 and 1926 is applicable to irrevocable trusts created be-

fore the enactment of the Revenue Act of 1924 and is not unconstitutional when so applied. *Reinecke* v. *Smith,* No. 601, October Term, 1932, decided April 10, 1933; *Porter* v. *Commissioner,* No. 466, October Term, 1932, decided March 13, 1933.

III

There are additional reasons peculiar to the particular trusts here involved which tend to support the validity of the tax. In the three largest trusts it was provided that on the death of Wells the proceeds of the insurance policies should be used to purchase securities from his estate. This did not constitute a mere convenience. It obviated the necessity of selling securities of the estate at a forced sale when they might bring but a fraction of their true value. Moreover, it provided a hedge to the settlor's estate against depreciation, and a fund from which taxes and other expenses could be paid without loss to the estate through the depreciation of securities.

Under Trusts Nos. 4 and 5 Wells retained reversionary interests in the trust property, and he retained his interest in some of the insurance policies under these trusts.

There is room to doubt whether funded insurance trusts are valid under the laws of Minnesota. If they are invalid, Wells could terminate them at any time and would be taxable on their income. Moreover, "charitable" trusts were invalid in Minnesota when these trusts were created, and for

this reason Wells could have terminated Trusts Nos. 2 and 3.

ARGUMENT

Section 219 (h) of the Revenue Act of 1924 (*infra*, p. 34) provides that—

> where any part of the income of a trust is or may be applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in paragraph (10) of subdivision (a) of section 214 [relating to charitable purposes]), such part of the income of the trust shall be included in computing the net income of the grantor.

The same provision is contained in Section 219 (h) of the Revenue Act of 1926.

So far as the construction of this provision is concerned, it is plain that the court below was correct in holding (R. 60–61) that it is applicable to irrevocable trusts. Apart from the fact that the language of the provision and its legislative history (see Appendix B, *infra*, pp. 38–39) suggest no other construction, Section 219 (h) would be without significance if it were limited to revocable trusts, for revocable trusts are dealt with in Section 219 (g) of the statutes. Compare the construction of Section 302 (d) of the Revenue Act of 1924 in *Porter v. Commissioner*, No. 466, October Term, 1932, decided March 13, 1933.

I

SECTION 219 (h) OF THE REVENUE ACTS OF 1924 AND 1926 IS NOT UNCONSTITUTIONAL WHEN APPLIED TO INCOME OF AN IRREVOCABLE TRUST

The question in this case is not whether the amounts upon which the taxes are imposed are income within the meaning of the Sixteenth Amendment. The items involved are dividends from domestic corporations, and interest, both of which are clearly income. The only question is whether so much of this income as is involved in this case may be taxed to the settlor of the trusts. There is no effort to collect from the settlor a tax on all of the income of the trusts. The statute relates only to "such part of the income of the trust" as "is or may be applied to the payment of premiums upon policies of insurance on the life of the grantor."

As the statute seeks to tax nothing which is not income there can be no objection to its constitutionality as a direct tax not within the Sixteenth Amendment. The only other ground on which the constitutionality of the statute is attacked is that it operates to deprive the settlor of the trust of his property " without due process of law," contrary to the provisions of the Fifth Amendment of the Constitution. We submit that the statute is constitutional as a reasonable exercise of the taxing power of Congress.

The Fifth Amendment does not require Congress to levy the tax upon the beneficial owner of

the income. *Lucas* v. *Earl,* 281 U.S. 111; *Burnet* v. *Leininger,* 285 U.S. 136. Compare *Poe* v. *Seaborn,* 282 U.S. 101, 109, where the Court held that a statute should be construed to tax income to its owner, "in the absence of further definition by Congress." Congress may, in a proper case, levy the income tax upon one who has no legal title to the income or the corpus producing it and who did not in fact receive the income, and had no power to reclaim the income which had been paid when the taxing statute was passed. *Corliss* v. *Bowers,* 281 U.S. 376. This is true even though the settlor's power over the income is at all times subject to a veto power in another over whom the settlor has no legal control. *Reinecke* v. *Smith,* No. 601, October Term, 1932, decided April 10, 1933. Finally, it is established that the settlor may be taxed although he has retained no beneficial interest in the property and no power to revest the property in himself. *Porter* v. *Commissioner,* No. 466, October Term, 1932, decided March 13, 1933.[3]

It is, therefore, not enough for the settlor to show he had no legal or equitable interest in the corpus of the trust or the income from it. The taxpayer was accountable to another for the in-

[3] The *Porter case* involved an estate tax rather than an income tax. But it is applicable here because "the same considerations as to ownership and control affect the power to impose a tax on the transfer of the corpus and upon the income." *Reinecke* v. *Smith,* No. 601, October Term, 1932, decided April 10, 1933.

come involved in *Lucas* v. *Earl* and *Burnet* v. *Leininger,* and he had no "title" to that involved in *Corliss* v. *Bowers.* And the respondent does not sustain his position by showing that he could not personally consume the income or principal of the trusts and could exercise no control over the trusts beyond that which he impressed on them by creating them. In *Porter* v. *Commissioner* the taxpayer had no possibility of retaking for himself either the income or the principal of the trust. In cases governed by *Reinecke* v. *Smith,* control in fact over the trust is immaterial; if the person whose consent is required refuses to comply with the settlor's wishes, he is nevertheless taxable on the income although he in fact has no control over either the trust property or income. The question presented is not one of "title" or "ownership" or actual "control," but whether the circumstances are such that it cannot be said to be unreasonable for Congress to tax to the settlor so much of the trust income as is used to pay premiums on policies of insurance on his own life.

Doubtless, a man may escape taxation on income from property by giving it to another without reservation of benefits to himself from the use of the property; but we submit that Congress may properly say that nothing less than an outright gift will be sufficient to achieve that result. Compare *Marshall* v. *Commissioner,* 57 F. (2d) 633 (C.C.A. 6th), certiorari denied, 287 U.S. 621. Wells did not

make an outright unqualified gift of the property the income from which is in question here. Cf. *Basket* v. *Hassell*, 107 U.S. 602; *Burnet* v. *Guggenheim*, No. 283, October Term, 1932, decided February 6, 1933. Instead he chose the trust device and withheld from the beneficiaries all right to either principal or income of the trusts (so far as is involved in this case) until his death. In so doing he impressed upon the trust property his will and his purpose.

The disposition thus made was in essence testamentary. It takes final effect at Wells' death and because of his death. Until his death the trust property used to pay premiums on insurance on his life is set apart for that single purpose, and it is freed of that restriction only at his death. Not until his death do the beneficiaries obtain any right to receive the property or its income or its proceeds. Death is, therefore, the controlling event intended by the grantor of the trusts as precedent to their final effect. The trust property involved in this case could, therefore, be taxed by an appropriate statute as a part of Wells' estate.[4] If this conclusion be correct it follows that the tax imposed on the income of the property by Section 219 (h) is valid

[4] The fact that the transfers were irrevocable does not require a contrary conclusion. *Klein* v. *United States*, 283 U.S. 231; *Tyler* v. *United States*, 281 U.S. 497. Since the question here discussed is one of constitutional power and not one of statutory construction, cases such as *May* v. *Heiner*, 281 U.S. 238, are inapplicable.

upon the principle applied in *Reinecke* v. *Smith*, *supra*, p. 10.

So far as income devoted to the payment of premiums was concerned, no direct benefit was conferred upon the beneficiaries of the trusts until Wells' death. The income was not paid to them nor at their direction. On the contrary, the purposes served by the trusts were Wells' purposes. The trustee performed functions prescribed by Wells and achieved results desired by Wells. The trusts existed because of the control which Wells had exercised over the trust property, a control that continued so long as Wells lived, for until his death the trust property here involved could be used only as he had directed. Plainly, there is income in this case which Congress may tax (cf. *Atlantic Coast Line* v. *Daughton*, 262 U.S. 413, 420), and that income is being used during Wells' life pursuant to his directions and in execution of his plan for the management of property which will pass to persons designated by him as the beneficiaries of his bounty only upon his death.

This Court has decided that the payment of one's obligations by another constitutes taxable income to him whose obligation is discharged. In *Old Colony Trust Co.* v. *Commissioner*, 279 U.S. 716, the principle was applied to the payment of income taxes of an employee by an employer. In *United States* v. *Boston & Maine R.R. Co.*, 279 U.S. 732, it was held that the payment of income taxes of a lessor

by a lessee constituted income to the lessor. In *United States* v. *Mahoning Coal R. Co.,* 51 F. (2d) 208 (C.C.A. 6th), certiorari denied, 285 U.S. 559, it was held that this principle applied even though the lessee was under no obligation to pay the taxes. Similarly, it has been held that the payment of premiums by an employer on a policy of insurance on the life of the employee constitutes additional compensation to the employee even though the wife of the employee is named as the beneficiary. *Adams* v. *Commissioner,* 18 B.T.A. 381; *Danforth* v. *Commissioner,* 18 B.T.A. 1221.

We think these cases indicate that the intimate relation between Wells and the income from the trusts which was used to pay the premiums on insurance on his own life was sufficient to sustain the tax as neither arbitrary, unreasonable, nor capricious. It is true that the obligation of the settlor to provide for his dependents by means of insurance was not a legal obligation. But to make such provision for his dependents was nevertheless an obligation both social and moral, and commonly recognized as such by a man of the settlor's means. The fact that the obligation may not have been legally enforceable is immaterial here, for the settlor accepted the obligation by creating the trusts now in question and thus discharged the obligation he fully recognized. Many of the average person's expenditures are not made pursuant to legally enforceable obligations. But it is clear that

if another should make them for him the gain is the same whether or not the payment is strictly in discharge of a debt.[5]

The payment of the insurance premiums by the trustee out of the trust income, then, did confer a benefit upon the settlor of the trusts, measured by the amount of the premiums paid; for that payment operated to discharge an obligation from which the settlor wished to be relieved by providing for the payment of premiums on policies of insurance on his own life for the benefit of his dependents who should survive him.

We think that Congress was justified in assuming that where trusts of this sort are not created for philanthropic purposes, they are created in lieu of other provisions for the support of dependents and that the payment of the premiums from the trust income is a payment for the settlor's benefit as truly as if he had retained the trust property set apart

[5] In many States, real property taxes are not personal obligations of the property owner, yet if such an owner should place securities in trust for the purpose of using the income to pay his taxes it is plain that the payment would be income to him just as truly as if a debt to a third party enforceable by action against the debtor personally were so discharged. It is no answer to say that in the case of real property taxes nonpayment results in a lien on the property. The lien and its enforcement are merely incidental to forfeiture of the property for nonpayment, and the situation is thus legally no different from that here, where the result of nonpayment of the premium would be the forfeiture of the policies. In each situation a thing of value is lost unless the payment is made.

for the sole purpose of paying the premiums, and himself had paid the premiums from the income of the property. The settlor of the trust had a direct, personal, and pecuniary interest in keeping the insurance policies alive and derived an economic benefit from the discharge of the obligation to keep them alive which he imposed on the trustee.[6]

If Wells had retained the securities, collected the dividends, and used them to pay the premiums which he obviously intended to pay when he took out the policies, he would have been required to report the full amount of income and would not be entitled to a deduction for the premiums paid, since such expenses are regarded as personal expenses which are not deductible under Section 215 (a) (1) of the Revenue Acts of 1924 and 1926 (*infra*, p. 32). If Wells' contentions in this case are sustained he has accomplished, by indirect means, that which the law would not permit him to accomplish directly.

The net result of the trust arrangements which were set up in this case was that the trustee paid the premiums which the settlor himself would have

[6] This principle was applied in *Matter of Hartmann*, 133 Misc. 428. A testator provided in his will for the payment of premiums on insurance policies on the life of his son-in-law. It was held that the transfer tax on these sums was properly assessed against the son-in-law. The court said (p. 431): "this insurance meant just so much of the expenses of the household of the insured and beneficiary covered as they might themselves otherwise expend on insurance. It is a saving to the insured of the amount of the premiums which he might otherwise be required to pay, * * *."

been required to pay if he wished to keep the policies in force. The transfer of the contracts to the trustee was not for the purpose of abandoning the policies and giving up the insurance. The stocks were turned over to make sure that the premiums would be met. And when the trustee acted in performance of his obligation he was not paying premiums for himself but for someone else, and that person was the taxpayer, by whose will and direction alone the trustee was empowered to act at all. It cannot be said that the income was not the taxpayer's income merely because it did not pass through his hands.

Congress has provided that in the case of certain trusts where the income is not immediately distributable, the tax shall be paid by the trustee out of the trust income; but it need not tax all trust income in this manner. A trust is not an entity which Congress must recognize against its will. Private trusts have no existence as such apart from the persons whose interests they involve. Even if a trust is regarded as a "legal entity" it would not follow that the respondent's position here is correct. Congress has frequently provided that the separate entity, both of corporations and of individuals, shall be disregarded for tax purposes. Thus, Section 240 of the Revenue Act of 1918 required affiliated corporations to make a consolidated return regardless of their separate legal existence. Sections 203 and

204 of the Revenue Acts of 1924 and 1926, and similar provisions of other Acts, have disregarded the separate legal existence of corporations in certain circumstances for the purpose of determining gain or loss on the sale of property. *Newman, Saunders & Co.* v. *United States,* 36 F. (2d) 1009 (C.Cls.), certiorari denied, 281 U.S. 760; *Osburn California Corp.* v. *Welch,* 39 F. (2d) 41 (C.C.A. 9th), certiorari denied, 282 U.S. 850; *Perthur Holding Corp.* v. *Commissioner,* 61 F. (2d) 785, certiorari denied, March 13, 1933.[7] Nor are provisions such as these confined to corporations. The separate existence of individuals is disregarded for some purposes by the revenue laws, and these provisions have been upheld by this Court. *Taft* v. *Bowers,* 278 U.S. 470; *Cooper* v. *United States,* 280 U.S. 409. Cf. *Corliss* v. *Bowers,* 281 U.S. 376; *Reinecke* v. *Smith, supra.*

Provisions such as those just referred to are designed to equalize the burdens of taxation and to prevent evasion. Section 219 (h), we submit, has a similar purpose and similar justification. Paraphrasing the language of this Court in *Burnet* v. *Leininger,* 285 U.S. 136, we submit that the Congress, having the authority to tax the net income derived from property held in trust, could impose

[7] Cf. *Gann* v. *Commissioner,* 61 F. (2d) 201 (C.C.A. 7th), certiorari denied, 287 U.S. 650. See also Section 331 of the Revenue Act of 1918, involved in *Monarch Electric & Wire Co.* v. *Commissioner,* 38 F. (2d) 417 (C.C.A. 7th).

the liability upon the trust directly, as it did in Section 219 (h) of the Revenue Act of 1924 or upon the individual whose purposes were served by the trust, as in the section here involved.[8]

Section 219 (h) was adopted by Congress as a means to prevent evasion. (See Appendix B, *infra*, pp. 38–39. The opinion thus expressed by Congress was plainly well founded. The present case is not an isolated one. It is pointed out in the taxpayer's petition for certiorari in *DuPont* v. *Commissioner*, No. 791, October Term, 1932 (p. 5), that many cases of this type are now pending, and that over $4,000,000,000 was placed in insurance trusts during the years 1923 to 1930.

Section 219 (h) is similar in origin, purpose, and effect to other closely related provisions which have been uniformly upheld by this Court. *Corliss* v. *Bowers*, 281 U.S. 376; *Reinecke* v. *Smith*, No. 601, October Term, 1932, decided April 10, 1933; *Taft* v. *Bowers*, 278 U.S. 470; *Cooper* v. *United States*, 280 U.S. 409; *United States* v. *Phellis*, 257 U.S. 156. This Court has held repeatedly that the presumption is in favor of the constitutional validity of a statute, and that a statute will not be held unconstitutional unless its invalidity appears beyond a

[8] The language used in the *Leininger case* was (p. 142): "The Congress, having the authority to tax the net income of partnerships, could impose the liability upon the partnership directly, as it did under the Revenue Act of 1917 (40 Stat. 300, 303), or upon the 'individuals carrying on business in partnership', as in the statutes here involved."

reasonable doubt. See *Hylton* v. *United States,* 3 Dall. 171, 174; *Fletcher* v. *Peck,* 6 Cranch 87, 128; *Ogden* v. *Saunders,* 12 Wheat. 213, 217; *Legal Tender cases,* 12 Wall. 457, 531; *Sinking-Fund Cases,* 99 U.S. 700, 718; *Trade-Mark Cases,* 100 U.S. 82, 96; *Mugler* v. *Kansas,* 123 U.S. 623, 661; *Nichol* v. *Ames,* 173 U.S. 509, 514–515; *Buttfield* v. *Stranahan,* 192 U.S. 470, 492; *Graves* v. *Minnesota,* 272 U.S. 425, 428; *Whitney* v. *California,* 274 U.S. 357, 371. In view of the fact that Congress has found the provision in question necessary "to stop this evasion" (Senate Report No. 398, 68th Cong., 1st Sess., p. 25), Section 219 (h) in the Revenue Acts of 1924 and 1926 is a necessary and proper law for carrying into execution the power of Congress to lay and collect taxes on incomes, within Article I, Section 8, of the Constitution.

The present case is clearly distinguishable from *Hoeper* v. *Tax Commission,* 284 U.S. 206, where this Court held that a State could not require a husband to pay taxes on the income of his wife which he never owned, controlled, or had the right to have expended for his benefit. The distinction stated by this Court in *Reinecke* v. *Smith, supra,* is equally applicable here:

> The case is plainly distinguishable from *Hoeper* v. *Tax Commission,* 284 U.S. 206, on which respondents rely, for there the at-

tempt was to tax income arising from property always owned by one other than the taxpayer. He had never had title to or control over either the property or the income from it.

In the court below, the respondents contended that Section 219 (h) cannot be sustained as a gift tax, and *Heiner* v. *Donnan,* 285 U.S. 312, was relied on. With this contention we are in complete accord. The Government does not argue and has never argued that the statute in question may be sustained as a gift tax. The tax is obviously a tax on income and it is on this basis only that it may be sustained. We contend that the relation between Wells and the income used to pay premiums on insurance on his own life was not so remote that it was in any sense arbitrary or capricious to provide that Wells should pay the tax. There was no other person who, could with equal justice, be taxed. The beneficiaries did not receive the income. To impose the tax upon the trust estate would merely permit evasion of surtaxes by an artificial division of income because a part of the settlor's property was set aside to serve particular purposes which he wished to serve. In such a situation it was but simple justice to impose the tax upon him whose directions controlled the use to be made of the income so long as no other person received it or controlled its disposition.

II

SECTION 219 (h) OF THE REVENUE ACTS OF 1924 AND 1926 IS APPLICABLE TO IRREVOCABLE TRUSTS CREATED BEFORE THE ENACTMENT OF THE REVENUE ACT OF 1924, AND IS NOT UNCONSTITUTIONAL WHEN SO APPLIED

The only income involved in this case is income received during the years 1924, 1925, and 1926. Such income was plainly subject to tax under the provisions of the Revenue Acts of 1924 and 1926. It is immaterial that the trusts involved were created prior to the enactment of the taxing statue. Since the income arose during the tax years to which the Revenue Acts of 1924 and 1926 are applicable, there is no question of retroactivity involved.

The correctness of this proposition, we believe, both as a matter of the construction of the statute and of its constitutionality, is sufficiently demonstrated by the decisions of this Court in *Corliss* v. *Bowers*, 281 U.S. 376, and *Reinecke* v. *Smith*, No. 601, October Term, 1932, decided April 10, 1933, in both of which Section 219(g) of the Revenue Act of 1924 was held properly applicable to the income of trusts received in 1924 although the trusts had been created in 1922. See also *Porter* v. *Commissioner*, No. 466, October Term, 1932, decided March 13, 1933. This Court's decision in the *Smith case* is directly applicable:

> Nor do we think the act has such a retroactive effect as to render its requirements arbitrary within the principle announced as to estate and gift taxes in *Nichols* v. *Coolidge*,

274 U.S. 531; *Untermyer* v. *Anderson,* 276 U.S. 440, and *Blodgett* v. *Holden,* 275 U.S. 142. In those cases the issue was the validity of a tax on a transaction consummated before the enactment of the statute authorizing the exaction. In the present case the subject of the tax is not the creation of the trusts or the transfer of the corpus from the grantor to the trustees, but the income of the trusts which accrued after January 1, 1924, the effective date of the Revenue Act of 1924. Although the act was passed June 2, 1924, the imposition of the tax on income received or accrued from the beginning of the year has been held unobjectionable. *Cooper* v. *United States,* 280 U.S. 409, 411. Compare *Fawcus Machine Co.* v. *United States,* 282 U.S. 375, 379.

III

CONSIDERATIONS RELATING TO THE PARTICULAR TRUSTS INVOLVED IN THIS CASE

We contend that the arguments already advanced in this brief are sufficient to show the propriety of the tax involved in this case. If we are correct in this, it will be unnecessary for the Court to consider the arguments set out in this point of the brief. But if the arguments so far advanced are not sufficient to sustain the Government's position, we present here additional reasons peculiar to the particular trusts involved in this case which we believe support, at least in part, the validity of the tax.

A

As to the three largest trusts involved in this case, there was a definite and material benefit reserved to the settlor. In Trusts Nos. 1, 4, and 5, it was provided that on the death of Wells the proceeds of the insurance policies should be used to purchase securities from his estate (R. 87, 121–122, 182–183). In other words, the income from these trusts, which went to pay premiums on the insurance policies, was being used to accumulate a cash fund available to his estate immediately upon the death of the settlor. This did not constitute a mere convenience. The provision was of real pecuniary value to the settlor's estate, for it obviated *pro tanto* the necessity of selling securities of the estate at a forced sale when they might bring but a fraction of their true value. It was expressly provided that the securities were to be purchased at their "appraised value" (R. 87, 121, 182). Many items which might be contained in an estate have no market value; there is no ready sale for them. It is a matter of common knowledge that executors are often forced to sell assets for whatever they will bring in order to raise cash with which to pay taxes and other debts of the estate and that life insurance is often made payable to the insured's estate to prevent loss from disadvantageous sales of securities. Such losses were provided against by the settlor's "insurance fund" to provide cash with which to buy assets from the estate at their "appraised value."

Furthermore, securities of an estate are appraised as of the date of death, and the provision for the purchase of such securities at their appraised value effectively protects the estate, to the extent of the insurance, against depreciation of the securities after the decedent's death. Such protection, as the experience of recent years has disclosed, is of the most vital importance in preserving an estate subjected to heavy death duties based upon value at death, which in times of falling security prices have been known to consume the realizable depreciated value of entire estates. Thus the provision was of most substantial pecuniary value to the settlor's estate, not only in obviating the necessity of selling securities at a sacrifice but in providing a hedge against depreciation of the appraised value of the securities and a fund from which taxes and other expenses of administration could be paid without loss to the estate through the depreciation of securities.

B

Under Trust No. 4, the trustee was directed to collect the proceeds of the life insurance policies at Wells' death, and in the event of his death by accident, the proceeds of those policies, and use them, with any unexpended income, in the purchase of securities from his estate at their appraised value. Upon the death of each of his three sons or his daughter, a portion of the corpus was to be distributed to such person or persons as were entitled

to receive it by the laws of descent in Minnesota. Wells would take under those laws if his children died intestate without issue or spouse. Mason's Minnesota Statutes (1927), Sections 8720, 8726. Thus Wells or his estate may ultimately receive the entire corpus of this trust, both the original corpus and the proceeds of the policies. Cf. *Klein* v. *United States,* 283 U.S. 231.

Policies Nos. 181485 and 181486 of the Provident Life and Trust Company of Philadelphia were payable to Mary D. Wells, if living, otherwise to the settlor's executors, administrators, or assigns, with the right reserved to change the beneficiary, and providing that if any beneficiary, revocably or irrevocably designated, dies before the insured, the interest of the beneficiary shall vest in the insured unless otherwise specifically provided (R. 150–151, 155–156). Wells made one assignment of these policies to his wife, which was subsequently released. On June 25, 1923, he purported to assign all of his right, title, and interest in them to the Minneapolis Trust Company as trustee (R. 154). There is an endorsement on these policies, however, showing that the beneficiary was revocably changed to his estate in August 1923, that is, subsequent to the assignment (R. 151, 156). It must be assumed that this was done with the concurrence of the trustee (assignee), as otherwise it would be ineffectual. See *N.Y. Mutual Life Ins. Co.* v. *Armstrong,* 117 U.S. 591; *Grigsby* v. *Russell,* 222 U.S. 149; *Insurance Co.* v. *Kimball,* 119 Me. 571: *Hul-*

sey v. *Cotton States Fertilizer Co.,* 45 F. (2d) 388 (C.C.A. 5th). Hence the insured's estate is the beneficiary under these policies, subject perhaps to the right of the trustee to surrender them for cash.

Trust No. 5 contains the same provisions for the disposition of the corpus as is contained in Trust No. 4 and Wells has the same reversionary interest in that trust.

Provident Life Policy No. 181596 was identical with policy No. 181485 of that company just discussed under Trust No. 4 except that the right to change the beneficiary was not reserved. It was provided, however, that if any beneficiary, revocable or irrevocable, dies before the insured, the interest of such beneficiary shall vest in the insured unless otherwise specifically provided. On June 25, 1923, Wells executed an assignment to the Minneapolis Trust Company (R. 208) similar to his assignment in No. 181485, but subsequent to that time, that is on August 22, 1923, the beneficiary was revocably changed to his estate (R. 207).

As Mary D. Wells, the beneficiary, was still living as late as February 14, 1924 (R. 149), Wells does not appear to have had the power to execute the assignment of June 25, 1923. *Allis* v. *Ware,* 28 Minn. 166; *Wallace* v. *Mutual Benefit Life Ins. Co.,* 97 Minn. 27; 2 Cooley, *Briefs on the Law of Insurance,* 1090. Moreover, after the assignment was made the beneficiary was revocably changed to Wells' estate on August 22, 1923. If the assign-

ment was ineffective, it is clear that neither Wells nor the trustee had the right to change the beneficiary, that the wife has all the interest in the policy. If, however, Wells' wife subsequently died (it appears that Wells married Helen R. Golding in 1926, R. 115) the beneficial interest in the policy is in Wells under the provision that if the beneficiary should predecease him he would acquire her interest. If, however, both the assignment and the change of beneficiary are effective, Wells' estate is the beneficiary. In either event, therefore, the estate of Wells retains the beneficial interest in the policies, except so far as the trustee has the right under the trust agreement to surrender them for cash.

C

Two other arguments were advanced before the court below and were there decided against the Government. Although we do not concede the correctness of the decision below, the arguments are presented here in summary only, since they involve questions of the law of Minnesota.

(1) There is considerable doubt whether funded insurance trusts are valid under the laws of Minnesota. That State does not have the common-law system of trusts. Its legislature has erected a statutory system of personal property trusts, and the permissible purposes of such trusts are limited by enumeration. Mason's Minn. Stat. (1927), Sec. 8090 (5) and (6); *Shanahan* v. *Kelly*, 88 Minn. 202,

supra; Congdon v. *Congdon,* 160 Minn. 343. The purpose for which Wells created the trusts now in question, that is, to pay premiums on policies of accident and life insurance, is not one of the specified purposes. Since we have found no case upholding the validity of such trusts under the law of Minnesota, it cannot certainly be said that such trusts are valid. It should also be noted that it is by no means clear that funded insurance trusts are lawful accumulations, although *Congdon* v. *Congdon, supra,* apparently places no limitations on accumulations of personal property. See Hanna, *Some Legal Aspects of Life Insurance Trusts,* 78 U. of Pa. Law Rev. 346, 360–373; Bogert, *Funded Insurance Trusts and the Rule against Accumulations,* 9 Corn. Law Quart. 113; *The Legality of a Funded Insurance Trust under the Statutes against Accumulations,* 27 Col. Law Rev. 197. If the trusts were invalid either because not within the permissible purposes of personal property trusts or as unlawful accumulations, Wells of course was entitled to terminate them at any time, and would therefore be taxable on their income. *Corliss* v. *Bowers,* 281 U.S. 376.

(2) At the time of the creation of the trusts in question, "charitable" trusts were invalid in Minnesota. *Shanahan* v. *Kelly,* 88 Minn. 202; *Bemis* v. *Northwestern Trust Co.,* 117 Minn. 409; *In re Ford's Estate,* 144 Minn. 454; Fraser, *Suspension of the Power of Alienation,* 9 Minn. Law Rev. 314,

321, 323–324. A statute of 1927 made "charitable" trusts valid, Mason's Minn. Stat. (1927), Sec. 8090–1, but there is nothing to show an intent to depart from the usual rule that statutes have prospective effect only, and there is much to show the contrary in Section 8090–4.

Under Trusts Nos. 2 and 3 it was provided that upon Wells' death the corpus of the trusts should pass directly to the Minneapolis Foundation in trust for the purpose of carrying on the work of the Wells Memorial, a charity conducted by St. Marks Church of Minneapolis (R. 97–98, 109). These trusts also provided that if *either* the living (funded insurance) trust or the perpetual (charitable) trust be declared void as a trust then "the trust estate shall revert to myself, if living; otherwise to my heirs, executors, administrators, or assigns" (R. 98–99, 109). Under the Minnesota statutes cited above, we submit that the disposition of the corpus of the trust on Wells' death was invalid, since it provided for a charitable trust. If this contention is correct, it rested with Wells to determine whether and when he would take possession of the trust property, including the premium income taxed by the Commissioner, and there can be no objection to taxing him upon such income.

The court below in holding the charitable trust valid relied on *Y.M.C.A.* v. *Horn,* 120 Minn. 404. But the decision in the *Y.M.C.A. case* merely rec-

ognizes that property may be given to a charitable corporation for use within its corporate purposes, and that there is no objection to a trust for such a corporation. Such a trust is not void for want of certainty in its beneficiaries; it has a definite beneficiary, the corporation. In the present case the income is to be paid to the rector, wardens, and vestrymen of St. Marks Church "to be used by said corporation for the sole purpose of carrying on the work of the Wells Memorial, a definite charity conducted by the said Church Corporation." It does not appear that the Wells Memorial was within the corporate purposes of St. Marks Church. Charitable trusts have been held invalid in Minnesota since the decision in the *Y.M.C.A. case*. See *Bogart* v. *Taylor*, 144 Minn. 454.

CONCLUSION

The decision of the Circuit Court of Appeals is erroneous and should be reversed.

Respectfully submitted.

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APRIL, 1933.

APPENDIX A

STATUTES AND REGULATIONS INVOLVED

REVENUE ACT OF 1924, C. 234, 43 STAT. 253, 264, 265, 271, 275

SEC. 210. (a) In lieu of the tax imposed by section 210 of the Revenue Act of 1921, there shall be levied, collected, and paid for each taxable year upon the net income of every individual (except as provided in subdivision (b) of this section) a normal tax * * * (U.S.C., Title 26, Sec. 951).

SEC. 211. (a) In lieu of the tax imposed by section 211 of the Revenue Act of 1921, but in addition to the normal tax imposed by section 210 of this Act, there shall be levied, collected, and paid for each taxable year upon the net income of every individual a surtax as follows: * * * (U.S.C., Title 26, Sec. 952).

SEC. 215. (a) In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses:

* * * * *

(U.S.C., Title 26, Sec. 956.)

SEC. 219. (a) The tax imposed by Parts I and II of this title shall apply to the income of estates or of any kind of property held in trusts, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) Except as otherwise provided in subdivisions (g) and (h), the tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that—

* * * * *

(2) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under paragraph (3) in the same or any succeeding taxable year:

(3) In the case of income received by estates of deceased persons during the period of administra-

tion or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

* * * * *

(g) Where the grantor of a trust has, at any time during the taxable year, either alone or in conjunction with any person not a beneficiary of the trust, the power to revest in himself title to any part of the corpus of the trust, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor.

(h) Where any part of the income of a trust may, in the discretion of the grantor of the trust, either alone or in conjunction with any person not a beneficiary of the trust, be distributed to the grantor or be held or accumulated for future distribution to him, or where any part of the income of a trust is or may be applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in paragraph (10) of subdivision (a) of section 214), such part of the income of the trust shall be included in computing the net income of the grantor. (U.S.C., Title 26, Sec. 960.)

REVENUE ACT OF 1926, C. 27, 44 STAT. 9, 21, 28, 32

SEC. 210. (a) In lieu of the tax imposed by section 210 of the Revenue Act of 1924, there shall be levied, collected, and paid for each taxable year upon the net income of every individual (except as provided in subdivision (b) of this section) a normal tax * * * (U.S.C.App., Title 26, Sec. 951).

SEC. 211. (a) In lieu of the tax imposed by section 211 of the Revenue Act of 1924, but in addition to the normal tax imposed by section 210 of this Act, there shall be levied, collected, and paid for each taxable year upon the net income of every individual a surtax as follows: * * * (U.S.C. App., Title 26, Sec. 952).

Sections 215 (a) (1) (U.S.C.App., Title 26, Sec. 956), and 219 (a), (b) (2) and (3), (g) and (h) (U.S.C.App., Title 26, Sec. 960) of the Revenue Act of 1926 are identical with the corresponding provisions of the Revenue Act of 1924 above quoted.

TREASURY REGULATIONS 65, PROMULGATED UNDER THE REVENUE ACT OF 1924

ART. 341. *Estates and trusts.*—In general, the income of a trust for the taxable year which is to be distributed to the beneficiaries must be returned by and will be taxed to the respective beneficiaries, but the income of a trust which is to be accumulated or held for future distribution, whether consisting of ordinary income or gain from the sale of assets included in the corpus of the trust, must be returned by and will be taxed to the trustee. The exception to this general rule is with respect to the income of a trust revocable by the grantor, and the

income of a trust which may be distributed to the grantor or used to pay the premiums upon policies of insurance on his life, which income, whether or not distributed, must be returned by and will be taxed to the grantor of the trust. (See article 347.)

See section 225 and articles 421 and 423 with reference to fiduciary returns, and article 294 with reference to deductions.

* * * * *

ART. 347. *Income of trusts taxable to grantor.*— In the case of certain trusts which are in whole or in part subject to revocation by the grantor, or which are for the benefit of the grantor, the income of the trust is to be included in computing the net income of the grantor. The income of such trusts must be so included, whether or not the trust was created before the enactment of this Act. The cases in which the income of the trust is to be included, in whole or in part, in computing the net income of the grantor are as follows:

(1) Where the grantor of the trust has, at any time during the taxable year, either alone or in conjunction with a person not a beneficiary of the trust, the power to revest in himself title to any part of the corpus of the trust, the income of such part of the trust for that taxable year shall be included in computing the net income of the grantor. The grantor shall include in his income the entire gross income of such part of the trust, and shall be entitled to such deductions with reference to such income as he would have been entitled to if the trust had not been created. Where the grantor relinquishes during the taxable year his power to revest in himself title to the corpus of the trust, the income of the trust shall be taxable to the grantor only for the period during which he had such power.

(2) Where any part of the income of the trust may, in the discretion of the grantor of the trust, either alone or in conjunction with any person not a beneficiary of the trust, be distributed to the grantor or be held or accumulated for future distribution to him; and

(3) Where any part of the income of the trust is or may be applied to the payment of premiums upon policies of insurance on the life of the grantor, other than policies irrevocably payable for the purposes and in the manner specified in section 214 (a) (10), such part of the income of the trust shall be included in computing the net income of the grantor.

The term "beneficiary" as used in this article includes any person entitled to an interest in the income or the principal of a trust, but does not include one having merely a nominal interest in the income or principal.

Article 341 and Article 347 of Treasury Regulations 69 promulgated under the Revenue Act of 1926 are identical in all material respects.

APPENDIX B

LEGISLATIVE HISTORY OF SECTION 219 (H) OF THE REVENUE ACT OF 1924

The provisions contained in Section 219 (h) of the Revenue Act of 1924 had not been included in earlier revenue laws. When the bill which became the Revenue Act of 1924 was introduced in the House of Representatives, the report of the Committee on Ways and Means explained the purpose of the provisions of Section 219 as follows (House Report No. 179, 68th Cong., 1st Sess., p. 21):

> This section has been rewritten in order to secure clarity and to prevent the evasion of taxes by means of estates and trusts. The changes made are quite important.
>
> It is provided in the section that in the case of a trust where the trustee has the discretion to distribute or not, the income is taxed to the beneficiary if distributed and to the trustee if not distributed.
>
> Subdivision (g) of this section provides that where the grantor of a trust reserves the right to change the trust in favor of himself the income is taxed to the grantor.
>
> Subdivision (h) of this section provides that the income of a trust which may be distributed to the grantor or which may be used for the payment of premiums upon policies of insurance on his life shall be included in the gross income of the grantor. Trusts have been used to evade taxes by means of provisions allowing the distribution of the income to the grantor or its use for his benefit. The purpose of this subdivision of the bill is to stop this evasion.

The report of the Senate Committee on Finance (Senate Report No. 398, 68th Cong., 1st Sess., pp. 25–26), expressed the same purpose as to the prevention of evasion of taxes by estates and trusts, made use of the expression "revocable trust" in discussing Section 219 (g), and as to Section 219 (h) contained the following (pp. 25–26):

> (3) Subdivision (h) of this section provides that the income of a trust which may be distributed to the grantor or which may be used for the payment of premiums upon policies of insurance on his life shall be included in the gross income of the grantor. Trusts have been used to evade taxes by means of provisions allowing the distribution of the income to the grantor or its use for his benefit. The purpose of this subdivision of the bill is to stop this evasion.
>
> The provisions of the House bill have been altered to exclude from taxation to the grantor of a trust income thereof used to pay premiums on insurance policies which are irrevocably payable to the benevolent organizations described in section 214 (a) (10). A trust of this kind is a proper method of providing for a gift to such organizations, and since the income is being used for these benevolent purposes rather than for the grantor's personal benefit it should not be taxed to him.

U. S. GOVERNMENT PRINTING OFFICE: 1938